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SUBJECT: VENEZUELA'S POWER SECTOR: HEADING FOR ANOTHER CRISIS?

Classified By: Economic Counselor Richard Sanders for reasons 1.4 (b) a
nd (d)

SUMMARY

¶1. (C) After dodging the drought bullet in 2003, Venezuela's power sector is once again (still?) in a fragile state. This time, however, other weaknesses in the electric power system caused by lack of investment, government inattention, and political meddling are taking center stage. The problems are centered around CADAFE, a state-owned company that is largely responsible for the national transmission grid. Legendarily inefficient and corrupt, CADAFE is described as "untouchable" under the Chavez regime, according to industry sources. In fact, CADAFE is reportedly a test case for populist "co-management" structures for the GOV. The Chavez Government has also shown a willingness further to threaten the electric power system with political retaliation against top managers. End Summary.

THE RAINS SAVE THE DAY

¶12. (U) Venezuela's installed electrical generation capacity is 20,908 MW, of which about 13,500 MW or approximately 65 percent is provided by hydroelectric stations. The largest of these, Guri (the world's third largest dam by one measure), located in the southwest of the country, delivers 9,025 MW alone. In 2003, the water levels in the Guri reservoir reached historic lows. This led to fears that power would have to be drastically rationed. The early onset of the rainy season, however, forestalled what might have been yet another blow to Venezuela's battered economy. As of April 29, 2004, the dam's water level stood at 252.45 meters above sea level or about 7.90 meters higher than the historic minimum set in 2003. While the water level is low, the operations of Guri's turbines are not expected to be at risk in 2004. Instead, other weaknesses in the Venezuelan electric power system caused by lack of investment, government inattention, and political meddling are taking center stage. Much of the concern about the system is focused on CADAFE (Compania Anonima de Administracion y Fomento Electrico), a state-owned company that, in addition to managing thermal electric plants such as the Planta Central plant near Caracas, is also responsible for the national transmission grid and transmits and distributes electricity to about 80 percent of Venezuela.

ELECTRICAL SECTOR FAILURE

¶13. (C) On March 31, emboffs met with Carlos Mibelli, President of the Venezuelan Association of Power Companies (CAVEINEL), for a sectoral overview. Mibelli praised GOV efforts to introduce a regulatory framework in 2001 but cautioned that significant work needed to be done to create a truly competitive market. He pointed to CADAFE, the largest national operator, as the source of most of the sector's inefficiency. Mibelli estimated CADAFE's average "non-technical losses," i.e., theft by illegal hook-ups, at 40 percent and said he did not foresee any real effort to streamline the company's corrupt operations and management because of CADAFE's untouchable status under the Chavez administration. Mibelli described the industry's public enterprises as well into a process of "slow death" since rates were only allowed to increase by 10 percent in the last two years, far below inflation. He predicted the GOV's maintenance of a populist stance towards the sector would result in long-term system failure.

¶14. (C) Miguel Lara, General Manager of OPSIS, the Office for the Operation of Interconnected Systems, identified the main problem for Venezuela's power sector as the lack of long-term planning on the part of the GOV. In an April 1 meeting, Lara explained that OPSIS had been created in 1968 to manage the planning, operation and interchange of energy between the largest public and private generation companies in Venezuela. As a large part of the country's power is hydro-generated,

said Lara, periodic droughts can have a significant impact on the system's ability to deliver electricity. 2003 saw one of the biggest droughts in Venezuelan history, resulting in a season of rolling blackouts. Lara called Venezuela's thermal

generation facilities deficient. He said a crisis was averted in 2003 only because a long-anticipated contribution from the Caruachi Dam on the Caroni River in southwestern Venezuela finally entered the grid and demand fell dramatically due to the economic contraction.

15. (C) Lara expected demand for power to grow 5-6 percent in 2004 putting significant additional stress on an already overloaded system. Caruachi may be able to generate enough power to meet increasing demand in the next few years, however, there are no long range plans for other projects in development at this time. Lara predicted this lack of long-term infrastructural planning would inevitably lead to a system crisis at some point in the future.

POLITICIZATION OF THE POWER SECTOR

16. (C) The power sector has also felt the effects of the political retaliation that has followed the effort to force a presidential recall election. On March 19, econoff met with Ciro Portillo, former Vice President of ENELVEN (Energia Electrica de Venezuela), a state-owned utility serving the western part of Zulia state. According to Portillo, 18 Enelven managers were informed by their supervisors on March 2 that they would be immediately fired unless they agreed to retract their signatures on the presidential recall petitions. One manager subsequently retracted but the remaining 17, each with an average of 20 years of experience and a total of 350 years of power sector experience between them, were either forced to retire or given severance packages. Portillo, who had had 36 years in ENELVEN, reported that it was made clear to him that if he did not go quietly he would not receive any retirement benefits. In the March 31 meeting with CAVEINEL President Mibelli, Mibelli told econoffs he had seen another list of 80 mid-level ENELVEN employees who were being pressured to recant their signatures. Other politically-motivated harrassment has been reported in EDELCA (Electrificacion del Caroni), the state-owned company that handles the massive hydroelectric projects on the Caroni river. Finally, econoff learned on April 2 that Miguel Lara and two other top OPSIS managers would also be forcibly retired because they had signed presidential recall petitions.

CADAFE: A FAILING EXPERIMENT?

17. (C) On April 6, Econoff called on Andres Gluski, President of Electricidad de Caracas (majority U.S.-owned by AES Corp.), to ask his opinion about the dire predictions for the stability of the electrical power sector. Gluski confirmed that Venezuela's power system is in a fragile state. Gluski said that in early March the system had come close to a major blackout. At that time, EDC had a turbine down for scheduled maintenance and, while this should not have been a problem, CADAFE also had had two of its three turbines at Planta Central off-line because of unexpected problems. Gluski noted his concern that a blackout affecting Caracas would give the GOV an excuse to call for a state of emergency. Ultimately, a blackout was avoided. Given CADAFE's problems, Gluski commented that the entire Venezuelan electricity system could be at risk of destabilization. He also pointed to the critical role played by OPSIS in managing national load factors, stating that if Miguel Lara and other top OPSIS managers depart, OPSIS will not be handled as efficiently and the effects of CADAFE's shortcomings will be magnified.

18. (C) Miguel Lara noted to econoff that CADAFE has routinely incurred huge losses since its inception due to corruption, bad management, a flawed billing system and low rate increases. He added that these problems have been exacerbated because of the political impossibility of criticizing CADAFE under this administration. According to Lara and Mibelli, CADAFE is being used as a test case for "co-management" structures under which a three tier system of circles (operations, management and executive circles) has been created to manage the company. In the operations circle, groups of approximately 20 workers jointly decide on company policies. Mibelli noted that as opposed to similar systems implemented in countries such as Japan where the managers would take the advice of workers and make a decision, in CADAFE the workers can override decisions by managers. Gluski added that a radical wing of the Patria

active in CADAFE. In sum, without a fundamental restructuring of CADAFE, these men predict uneven power distribution as a fact of life for the future.

COMMENT

19. (C) CADAFE was expected to be restructured as a result of a framework law governing generation, transmission and distribution passed by the Chavez Government in 2001. The law was intended to unbundle service activities and to create competition and a spot electricity market. Instead, it appears increasingly likely that the Chavez Government will not implement the law and CADAFE's many shortcomings will not be addressed. The Chavez Government has also shown a willingness further to threaten a fragile electric power system with the implementation of populist management structures and political retaliation against top managers. While the GOV should be considering steps to prepare for rationing, it appears to be ready to take the risk of a major power failure instead.

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